RE: SINGER QUESTIONS FOR THE RECORD

Dear Mr. Walden:

It is an honor to have the opportunity to inform Congress on such important matters in the communications industry. My answers to your questions are provided below. Please let me know if I can be of further assistance.

Thanks,

Hal J. Singer

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The Honorable Anna Eshoo asks: "As you know, Senator McCain recently introduced '*a la carte*' legislation to ensure consumers only have to buy those channels they want to watch. What is your view on Senator McCain's legislation and would it incent distributors to carry more independent programming?"

Although I am sympathetic to the problem that Senator McCain's legislation aims to address—bloated cable packages that ask consumers to pay for much content they never watch—I fear that an *ex ante* prohibition on wholesale and retail bundling ("mandatory unbundling") is not the right approach. Mandatory unbundling could raise programming costs to cable providers, who likely would pass these higher costs on to their consumers. It could also undermine the "flat tax" imposed on video households that supports "a diverse and thriving entertainment business without asking any group to pay too much for what they want." Below, I propose a few alternatives that would reduce the size of the cable package and promote video competition generally, including an *ex post* method for adjudicating wholesale-bundling disputes.

Online video offerings by Google, Netflix, Apple, and Amazon will likely force cable operators to pare back the size of their bundles. Price-sensitive customers can avoid the standard video offering by pairing a high-speed Internet connection with an online video subscription. This is not to say that online video has disciplined cable prices, as that would require cable customers to "cut the cord" with much greater frequency. According to Leichtman Research Group, in 2012 only 0.4 percent of U.S. households canceled their pay-television subscriptions in favor of getting video entertainment over the Internet.

Rather than mandating that cable operators react to these market forces with smaller packages of their own, I would look for ways to accelerate cord cutting. In particular, Congress should investigate the use of the following provisions in program-carriage agreements, which are likely designed to deny online video providers access to video programming: (1) exclusivity provisions that bar the supply of programming to online video providers; (2) higher license fees conditioned on a refusal to deal with online video providers; or (3) most-favored-nation (MFN) provisions. With respect to the latter, a program owner seeking to contract with an online distributor at a reduced license fee (relative to what it charges cable operators) might have to reimburse a cable operator for the difference in its license fee pursuant to an MFN, thereby thwarting such distribution arrangements.

Although fostering video competition is the best long-run approach, I acknowledge that there is a serious coordination problem among programmers and cable operators that prevents cable operators from paring down their packages in the short term. Programmers enjoy the benefits of generous license fees—even when few viewers are watching their network. And cable operators recognize that programmers could render their video services irrelevant by contracting with online distributors or even viewers directly. Moreover, much like the well-recognized "holdup problem" when several patents cover minor features of a single product, no individual programmer internalizes the cost of the cable bundle being too expensive, and therefore insists on maximum penetration, not only for its marquee content, but also for its less-compelling, sister networks.

How bloated will the cable package get before cable operators push back on programming bundlers? Cable operators have some recourse against wholesale bundling in courts, as evidenced by Cablevision's antitrust suit against Viacom. Yet antitrust litigation moves slowly and imposes a market-power requirement that might be impossible to satisfy for most bundling claims, as there are only a handful of cable networks with significant market power.

Accordingly, a less-restrictive "nudge" toward smaller cable packages could be in order. One idea would be for Congress to empower the FCC to adjudicate wholesale-bundling disputes between a cable operator and a programming owner. The FCC could investigate these complaints pursuant to a public-interest standard (as opposed to an antitrust standard). For example, the factfinder could seek to determine whether the "standalone price" for the most popular network in the bundle (that is, the price at which the program owner is willing to sell the network by itself) exceeds the price that would be charged by an independent owner of that network; if so, then the bundle likely reduces consumer welfare.

However, if a cable operator invoked such protection, it should be required to offer the networks in dispute *a la carte* to its customers *conditional on prevailing on the merits of its claims*—that is, there should be a cost to cable operators for invoking this regulatory protection. For example, if Cablevision were to invoke this new protection against Viacom, and if an administrative law judge at the FCC were to rule that Cablevision could purchase Viacom's networks separately, then Cablevision would be compelled to permit its customers to add Viacom's networks *a la carte* to any package offered by Cablevision, including its base package.

Perhaps this "voluntary" form of regulation could upset the current equilibrium and set in motion what Senator McCain really wants—smaller cable packages. Mandatory unbundling seems to be a bit heavy-handed and could affect independent cable networks in ambiguous ways. Under an *ex ante* prohibition on retail bundling, independent programmers could be exposed to less carriage (if customers never learn of their offerings) or more carriage (if cable operators cut loose the "tied" programming from bundlers to make room for more independents); it is hard to know which force is greater. In contrast, independent programmers that refrain from bundling would largely be unaffected under my alternative, which would bring about *a la carte* incrementally and on a voluntary basis.

The Honorable Henry Waxman asks: "I remain concerned about the challenges facing independent programmers as well as competition amongst distributors. How do you assess the changes in the video marketplace since the 1992 Cable Act? Have these changes resulted in the kind of diversity and competition Congress sought to foster for video? How would you respond to the argument that because only 14 percent of the networks available for distribution today are vertically integrated, the program access and program carriage rules are no longer needed?"

Within a representative *local* market, cable's market share has declined from roughly 91 percent in 1995 (the earliest available data on the FCC's website) to 59 percent as of 2010 (the latest available data on the FCC's website). In this sense, one of the primary goals of the Cable Act has been largely fulfilled. However, the bargaining position of *national* cable networks depends on, among other things, concentration at the *national* level. In their seminal book on vertical integration in cable programming, Professors Waterman and Weiss explain how foreclosure from even a small share of nationwide U.S. households could impair an independent network's ability to realize scale economies and compete effectively for advertisers and content.

Two major trends have happened since 1992 that push horizontal concentration among video distributors at a national level in opposite directions: (1) inroads by DBS (after securing access to broadcast networks) and telcos, and (2) the clustering of adjacent cable systems by cable operators. The former has reduced concentration (particularly in local markets where telcos have entered), while the latter has increased concentration nationwide. In 1992, the cable operator with the largest nationwide share of video subscribers was TCI with a roughly 18 percent share; by 2010, the cable operator with the largest nationwide share of video subscribers was Comcast with a roughly 23 percent share. In this sense, the bargaining position of national cable networks vis-à-vis the largest cable operator has *slightly deteriorated* since 1992.

Yet some who do not understand these dynamics (including one judge on the D.C. Circuit Court of Appeals) cite Comcast's *nationwide share* as a basis for dismantling the program-carriage rules and relying instead on antitrust courts. Under this logic, Congress sought to immunize all vertically integrated cable operators from the program-carriage rules when it passed the 1992 Cable Act—an absurd proposition. Should the D.C. Circuit's recent *Tennis Channel* decision stand, Congress will have to revisit the program-carriage rules, which have been effectively gutted by the new evidentiary standard. Asking an independent network to estimate the lost subscription revenues from a cable operator's not carrying that network more broadly is akin to asking an oyster vendor to estimate the lost sales receipts from a restaurant's not carrying oysters on the buffet; few customers are willing to switch cable operators (restaurants) from not being able to access one of hundreds of items on the dial (buffet).

Whether Comcast's nationwide market share would satisfy the requisite "foreclosure share" under the antitrust laws is an open question. Fortunately, it is a purely academic one, as Congress understood in 1992 that the program-carriage rules were designed to foster something clearly beyond the scope of antitrust—namely, programming diversity. And those rules still have an important role to play, as many independent networks such as Tennis Channel or MASN must vie for carriage by a vertically integrated cable operator that either possesses a similarly situated network or seeks to own the underlying rights of the independent network (or both). So long as fostering diversity in programming is still an important objective, there is no empirical basis to dismantle the program-carriage rules.

Although they are often perceived as two sides of the same coin, program carriage and program access are different animals. In particular, program access is designed to protect against a price increase by an affiliated cable network aimed at raising a rival's costs, which fits squarely within the scope of antitrust enforcement. Here, the FCC has been tasked with policing program access because it arguably can resolve these disputes faster than antitrust courts.

Economic theory shows that a vertically integrated cable network will raise its license fee relative to an independent network (carrying the same content) so long as withholding said content from a rival could induce some of the rival's customers to depart. Stated differently, program access is only a concern for "must-have" networks; setting aside bundled-pricing arrangements, there is no incentive to raise the price of a non-essential affiliated network over and above the price that would be charged by an independent owner.

Accordingly, that “only 14 percent of the networks available for distribution today are vertically integrated” is a largely irrelevant statistic. What matters instead is the share of must-have networks that are vertically integrated. According to paper in Review of Network Economics, over the past decade, nearly three-quarters of all regional sports networks (“RSNs”)—which carry must-have, local sports programming—were vertically integrated. Moreover, vertically integrated RSNs were shown to charge higher license fees than independent RSNs.

Unlike program-carriage rules, which were designed to address an issue (diversity) clearly outside the scope of antitrust, if program access rules were eliminated, rival distributors could seek recourse under the antitrust laws, albeit at a snail’s pace. This fallback makes program-access rules *relatively* less critical than program-carriage rules. However, because the FCC is better positioned to adjudicate these program-access disputes, and because many must-have networks are vertically integrated, there is no good reason to dismantle the program-access rules.